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No. 926 86

October Term 1959

IN THE

Supreme Court of the United States

THE CALIFORNIA COMPANY, a corporation,

Appellant,

v.

STATE OF COLORADO; ROBERT A. THEOBALD, as Director of Revenue of the State of Colorado; HOMER F. BEDFORD, as Treasurer of the State of Colorado,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF COLORADO

BRIEF IN OPPOSITION TO MOTION TO DISMISS

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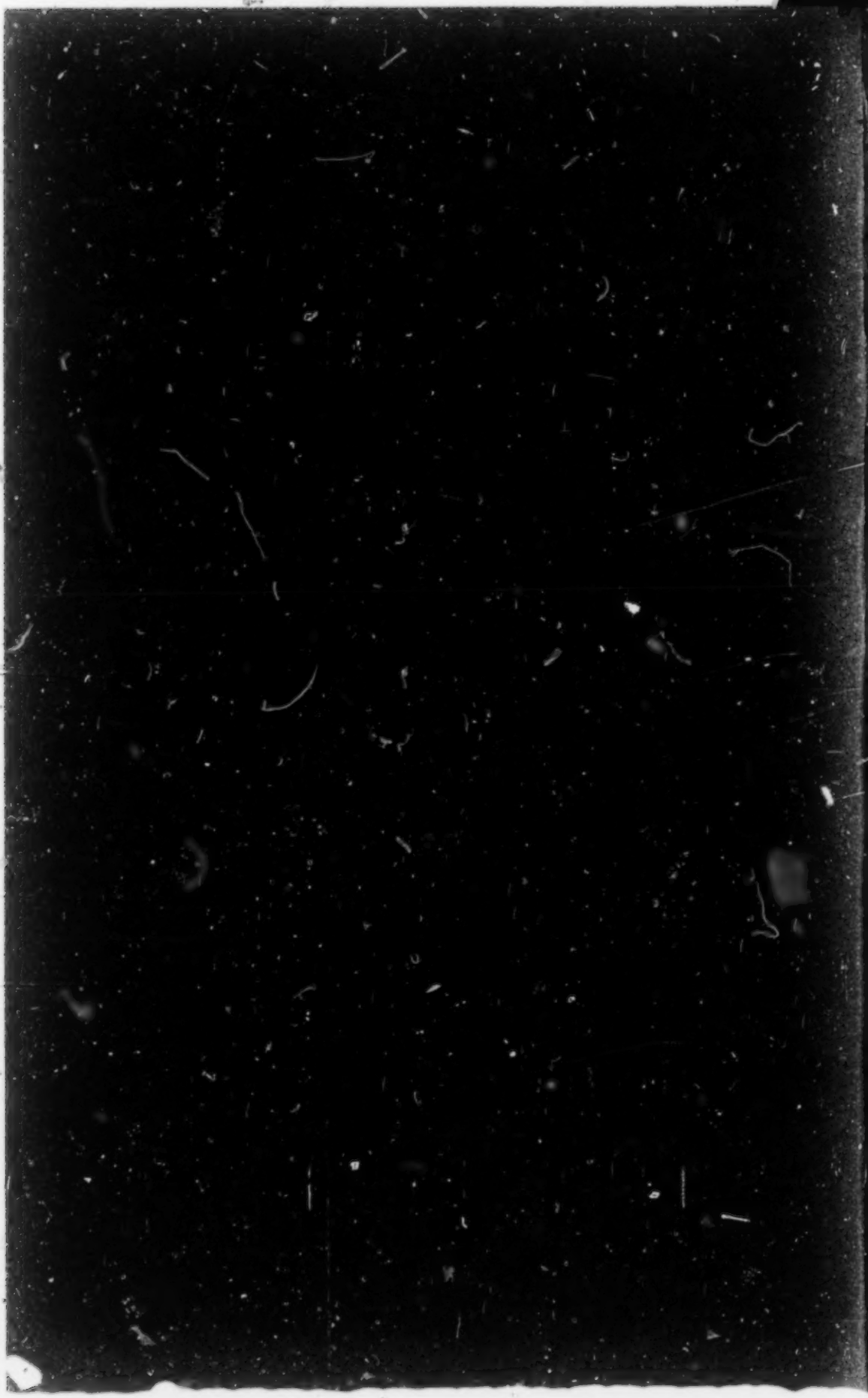

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No. 930

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Appellees move to dismiss the appeal, or to affirm the judgment below, on the ground that the questions presented are insubstantial.

Appellees' arguments are without merit.

I

THE DECISION OF THE SUPREME COURT OF COLORADO THAT THE GROSS INCOME TAX ACT IS NOT REPUGNANT TO THE FEDERAL EQUAL PROTECTION AND DUE PROCESS CLAUSES IS DIRECTLY CONTRARY TO CONTROLLING DECISIONS OF THIS COURT

The tax here in question is a graduated tax on "the entire amount realized from the sale or other disposition" of Colorado oil and gas (Jurisdictional Statement, pp. 59-60). The decision of the Supreme Court of Colorado sustaining this tax is without precedent.* Beyond this, its

*As we pointed out in the Jurisdictional Statement (p. 13), neither party to this action has discovered any case, federal or state, upholding the validity of a graduated tax on gross income or receipts.

ruling is directly contrary to the decisions of this court in *Stewart Dry Goods Co. v. Lewis*, (1935) 294 U. S. 550, 55 S. Ct. 525, 79 L. Ed. 1054, and *Valentine v. Great Atlantic and Pacific Tea Co.*, (1936) 299 U. S. 32, 57 S. Ct. 56, 81 L. Ed. 22. Appellees attempt to dispose of these controlling decisions, both holding invalid graduated taxes on gross sales or receipts, in two footnotes. As to *Stewart*, Appellees say (Motion to Dismiss, p. 6), "The tax was imposed upon all retailers, and took no account of the fact that margins of profit vary widely in the various retail enterprises"; and again (Motion to Dismiss, p. 9) "The * * * rationale of the *Stewart* decision is found in the fact that the taxpayer there demonstrated the lack of relationship between increasing volume of sales and net earnings". As to *Valentine*, Appellees say (Motion to Dismiss, p. 6) simply that it "rested entirely upon the authority of the *Stewart* case".

In its opinion in the *Stewart* case, however, the Court makes clear that a graduated tax on gross sales is "unjustifiably unequal, whimsical and arbitrary" in its operation on those engaged in the same business as well as in its operation on those in different businesses, and this despite a finding of fact by the trial court that as a general proposition increased volume of sales results in increased profits and increased ability to pay the tax. The Court said (294 U. S. 558-559):

> "The district court found that 'generally speaking' he who sells more is in receipt of a greater profit and hence has larger ability to pay, and upon this basis justified the classification. But it is to be remembered that the act in question taxes gross sales and not net income. * * *
>
> * * * * *
>
> "Argument is not needed, and indeed practical admission was made at the bar, that the gross sales of a merchant do not bear a constant relation to his net profits; that net profits vary from year to year in

the same enterprise; that diverse kinds of merchandise yield different ratios of profit; and that gross and net profits vary with the character of the business as well as its volume. The trial court made no finding that the relation between gross sales and net profits, or increase of net worth, was constant, or even that there was a rough uniformity of progression within wide limits of tolerance. Expert witnesses, using data assembled from various reporting agencies, endeavored to establish that net profits or net worth grow with increased sales. But their testimony not only indicated great variations within each class selected for comparison, but also showed that in some of the classes representing the greater amount of sales the net profit or addition to net worth is smaller than in a class having less aggregate sales. The best that can be said for this evidence is that averaging the results of the concerns making the reports it is true 'generally speaking,' as the court below put it, that profits increase with sales. The ratio of increase, however, differs in different lines of activity and even as between concerns carrying on the same business, and so many exceptions and reservations must be made that averages are misleading. The proofs submitted are insufficient to support the appellees' contention that the graduation of the tax was adjusted with reasonable approximation to the net earnings of the taxpayers, and that such minor and incidental inequalities as may be found are those always incident in the application of any valid general rule of classification. * * *"

Further, Appellees, while attempting to distinguish *Stewart* as a case involving a tax which "took no account of the fact that margins of profit vary widely in the various retail enterprises" (Motion to Dismiss, p. 6), fail to mention that in *Valentine* the graduated tax involved was measured by the gross receipts of those engaged in a single variety of retail enterprise, i.e., chain stores. In its opinion

holding the tax invalid, the district court said ((1935) 12 Fed. Supp. 760 at 765):

> "* * *. The limitation in the classification to the taxation of chain stores only could not change the nature of the tax, and this would be true, giving consideration to the distinctive business species of the chain stores and all economic and welfare questions which are brought about by their advantages in making sales. Such questions might well bear on the propriety of the classification, but not on what constitutes the form or nature of a tax."

This Court affirmed per curiam solely upon the authority of *Stewart*.

Appellees also seek to avoid the authority of *Stewart* and *Valentine* by contending that the gross income tax here in question can be sustained as an exercise of state police power directed toward the conservation of oil and gas. The Supreme Court of Colorado did not rely upon or even mention this contention (although it is mentioned by the Trial Court) and nothing in the opinion of the Supreme Court of Colorado suggests that that Court considered this taxing act to be in any way related to conservation. Manifestly the contention is without merit. The State of Colorado has enacted a statute dealing specifically and comprehensively with the conservation of oil and gas (Colorado Revised Statutes 1953, § 100-6-1, et seq.). The Colorado statute expressly defines and prohibits the waste of gas* and, after creating the Colorado Oil and Gas Conservation Commission, expressly gives that body exclusive authority in the following terms:

> "* * *. Any delegation of authority to any other state officer, board or commission to administer any and all other laws of this state relating to the conservation of oil or gas, or either of them, is hereby re-

*See page 7 of the Motion to Dismiss, where the relevant Section of the Colorado statute is quoted in part.

scinded and withdrawn and such authority is hereby unqualifiedly conferred upon the commission, as herein provided. * * *"

(Colorado Revised Statutes 1953, § 100-6-5)

Further, admitting (for the purposes of argument) that the greater the rate of production from a given oil and gas well, the greater the gas/oil ratio, under the Colorado tax act here in question a producer who flares gas would pay no tax thereon, since the tax is levied only on the "amount realized from the sale or other disposition" of oil and gas, whereas a producer who sells his gas would have to pay a graduated tax on the gross receipts therefrom. Clearly, therefore, this taxing statute does not discourage the flaring of gas and manifestly was not and is not intended to have any relation to the conservation of oil and gas.

In their attempt to distinguish *Stewart* and *Valentine*, Appellees aiso rely upon a finding of the Trial Court that "an increased rate of production *typically* results in an increased rate of net profit".* But this finding is no different, or more significant, than the finding in *Stewart* that "generally speaking" one who sells more is in receipt of a greater profit, a finding which this Court in that case held insufficient to sustain the statute. In the words of the Court in *Stewart*, "argument is not needed" that an increased rate of production of oil and gas does not always result in an increased rate of net profit.

There are four other substantial questions as to the reasonableness and validity of the Colorado tax. Appellant sets them forth on pages 3 and 4 of the Jurisdictional Statement. Appellees do not attempt to answer any of these questions.

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*Quoted at page 9 of the Motion to Dismiss. Emphasis ours.

II.

THE DECISION OF THE SUPREME COURT OF COLORADO THAT THE TAXING ACT IS NOT REPUGNANT TO THE FEDERAL COMMERCE CLAUSE IS DIRECTLY CONTRARY TO CONTROLLING DECISIONS OF THIS COURT

As pointed out in our Jurisdictional Statement (pp. 16-19), the decision of the Supreme Court of Colorado sustaining the Colorado gross income tax and holding that it is not repugnant to the federal commerce clause is directly contrary to the decisions of this Court, particularly *J. D. Adams Mfg. Co. v Storen*, (1938) 304 U. S. 307, 58 S. Ct. 913, 82 L. Ed. 1365, *Freeman v. Hewit*, (1946) 329 U. S. 249, 67 S. Ct. 274, 91 L. Ed. 265, and *Mich.-Wis. Pipe Line Co. v. Calvert*, (1954) 347 U. S. 157, 74 S. Ct. 396, 98 L. Ed. 583. Appellees seek to distinguish these cases by arguing that the tax is imposed on purely intrastate activities, and not interstate commerce.

Appellees assert (Motion to Dismiss, p. 11) that "the Colorado tax is imposed on the extraction of the oil, and before the sale by which the oil enters the flow of interstate commerce". In so doing they simply ignore the fact that the tax, being levied on "the entire amount realized from the sale or other disposition" of Colorado oil and gas, is not imposed on oil and gas extracted in Colorado and used as fuel in producing operations, but is imposed only on the gross income from oil and gas so extracted *and sold* (Jurisdictional Statement, pp. 7, 8, 18), which shows conclusively that the tax is not imposed on the extraction of the oil, but on its sale.

This fact alone distinguishes *Oliver Mining Co. v. Lord* (1923) 262 U.S. 172, 43 S. Ct. 526, 67 L. Ed. 929 and the other cases cited by Appellees with it (Motion to Dismiss, p. 12).

Appellees argue that the sales of oil taxed, being made in Colorado, are "exclusively intrastate," dismissing *Phillips Petroleum Co. v. Wisconsin* (1954) 347 U.S. 672,

74 S. Ct. 794, 98 L. Ed. 1035, rehearing denied (1954) 348 U.S. 851, 75 S. Ct. 17, 99 L. Ed. 670, as a case which "involved the duty of the Federal Power Commission to regulate the price paid by interstate pipelines for natural gas ultimately sold to consumers in other states" (Motion to Dismiss, p. 11). This is a curious inversion of the holding in that case. Under the Natural Gas Act (15 U.S.C., sec. 717, et seq.), the Federal Power Commission is authorized to regulate the rates charged for the transportation of natural gas in interstate commerce, or for the sale in interstate commerce of natural gas for resale—not the prices paid by interstate pipe lines. In *Phillips* the Court held that the Act applied to an independent producer selling gas in the state in which it was produced to one who transported it out of the state and sold it to others. The Court said (347 U.S. 677):

> "Petitioners admit that Phillips engages in 'the sale in interstate commerce of natural gas for resale,' as, of course, they must. Interstate Natural Gas Co. v. Federal Power Com. 331 US 682, 687-689, 91 L ed 1742, 1746-1748, 67 S Ct 1482; cf. Michigan-Wisconsin Pipe Line Co. v. Calvert, 347 US 157, 166-168, 98 L ed 583, 591, 592, 74 S Ct 396.* * *"

So here the sales of oil taxed, even though made in Colorado, where the oil was produced, were sales in interstate commerce, and not "exclusively intrastate," as Appellees contend.

Appellees also argue that even if the activities taxed were wholly interstate, the tax imposes on The California Company no more than its fair share of the tax burden, and is therefore valid, citing *Northwestern States Portland Cement Co. v. Minnesota* (1949) 358 U.S. 450, 79 S. Ct. 357, 3 L. Ed. 2d 421, and *West Publishing Co. v. McColgan* (1946) 328 U.S. 823, 66 S. Ct. 1378, 90 L. Ed. 1603. Those cases involved state taxes on a portion of the net income of foreign corporations earned from activities carried on within the taxing state. The tax in question here is a tax

on "the entire amount realized," without any apportionment. No holding as to a tax on net income, fairly apportioned, can determine the validity of a tax on the gross receipts from interstate sales, graduated or otherwise, without apportionment.

Appellees stress the local activities which, they say, forge the minimum connections necessary to satisfy jurisdictional requirements for the imposition of the tax. But as said by this Court in *Nippert v. City of Richmond* (1946) 327 U.S. 416, 423-424, 66 S. Ct. 586, 589-590, 90 L. Ed. 760, 764:

> "It has not yet been decided that every state tax bearing upon or affecting commerce becomes valid, if only some conceivably or conveniently separable 'local incident' may be found and made the focus of the tax. This is not to say that the presence of so-called local incidents is irrelevant. On the contrary the absence of any connection in fact between the commerce and the state would be sufficient in itself for striking down the tax on due process grounds alone; and even substantial connections, in an economic sense, have been held inadequate to support the local tax. But beyond the presence of a sufficient connection in a due process or 'jurisdictional' sense, whether or not a 'local incident' related to or affecting commerce may be made the subject of state taxation depends upon other considerations of constitutional policy having reference to the substantial effects, actual or potential, of the particular tax in suppressing or burdening unduly the commerce. * * *"

That the tax in question suppresses or burdens interstate commerce unduly is shown by *J. D. Adams Mfg. Co. v. Storen* (1938) 304 U.S. 307, 58 S. Ct. 913, 82 L. Ed. 1365, and the other cases cited by Appellant on pages 18 and 19 of

the Jurisdictional Statement. Appellees make no attempt to distinguish or explain any of these cases in this connection.*

In *J. D. Adams* the Court struck down an Indiana tax on the gross receipts of an Indiana manufacturer from sales of its products in intrastate, interstate and foreign commerce, saying (304 U.S. 311-312):

> "The vice of the statute as applied to receipts from interstate sales is that the tax includes in its measure, without apportionment, receipts derived from activities in interstate commerce; and that the exaction is of such a character that if lawful it may in substance be laid to the fullest extent by states in which the goods are sold as well as those in which they are manufactured. Interstate commerce would thus be subjected to the risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids. We have repeatedly held that such a tax is a regulation of, and a burden upon, interstate commerce prohibited by Article 1, § 8 of the Constitution. The opinion of the State Supreme Court stresses the generality and nondiscriminatory character of the exaction but it is settled that this will not save the tax if it directly burdens interstate commerce."

In *Mich.-Wis. Pipe Line Co. v. Calvert* (1954) 347 U.S. 157, 74 S. Ct. 396, 98 L. Ed. 583, cited by Appellant (Jurisdictional Statement, p. 18), the Court had before it a tax on each thousand cubic feet of natural gas "gathered" in Texas, whether for transmission in interstate commerce or for local consumption. The Court held the tax invalid, with reasoning equally applicable here, saying (347 U.S. 165-166, 170):

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*Appellees do attempt to distinguish *Mich.-Wis. Pipe Line Co. v. Calvert* (1954) 347 U.S. 157, 74 S. Ct. 396, 98 L. Ed. 583, in so far as that decision bears on whether the tax here is imposed on interstate commerce. That point is dealt with supra, page 6.

"* * * Frequently it has been said that interstate business must pay its way, Postal Tel.-Cable Co. v. Richmond, 249 US 252, 259, 63 L ed 590, 594, 39 S Ct 265 (1919); Western Live Stock v. Bureau of Revenue, 303 US 250, 254, 82 L ed 823, 826, 58 S Ct 546, 115 ALR 944 (1938); and the Court has done more than pay lip service to this idea. Numerous cases have upheld state levies where it is thought that the tax does not operate to discriminate against commerce or unduly burden it either directly or by the possibility of multiple taxation resulting from other taxes of the same sort being imposed by other states. The recurring problem is to resolve a conflict between the Constitution's mandate that trade between the states be permitted to flow freely without unnecessary obstruction from any source, and the state's rightful desire to require that interstate business bear its proper share of the costs of local government in return for benefits received. Some have thought that the wisest course would be for this Court to uphold all state taxes not patently discriminatory, and wait for Congress to adjust conflicts when and as it wished. But this view has not prevailed, and the Court has therefore been forced to decide in many varied factual situations whether the application of a given state tax to a given aspect of interstate activity violates the Commerce Clause. It is now well settled that a tax imposed on a local activity related to interstate commerce is valid if, and only if, the local activity is not such an integral part of the interstate process, the flow of commerce, that it cannot realistically be separated from it. Memphis Natural Gas Co. v. Stone, 335 US 80, 87, 92 L. Ed. 1832, 1838, 68 S Ct 1475 (1948); Western Live Stock v Bureau of Revenue, supra, (303 U.S. at 258). And if a genuine separation of the taxed local activity from the interstate process is impossible, it is more likely that other states through which the commerce passes or into which it flows can with equal right impose a

similar levy on the goods, with the net effect of prejudicing or unduly burdening commerce.

* * * * *

"Here it is perhaps sufficient that the privilege taxed, namely the taking of the gas, is not so separate and distinct from interstate transportation as to support the tax. But additional objection is present if the tax be upheld. It would 'permit a multiple burden upon that commerce,' Joseph v. Carter & Weekes Stevedoring Co., supra (330 US at 429), for if Texas may impose this 'first taking' tax measured by the total volume of gas so taken, then Michigan and the other recipient states have at least equal right to tax the first taking or 'unloading' from the pipeline of the same gas when it arrives for distribution. Oklahoma might then seek to tax the first taking of the gas as it crossed into that State. The net effect would be substantially to resurrect the customs barriers which the Commerce Clause was designed to eliminate. * * *"

So here, if Colorado may tax the gross receipts from the sale of Colorado oil in interstate commerce, the next state in which that oil is sold may again tax the gross receipts from the second sale of that oil, whether in interstate commerce or for local consumption, and so on in successive states, and there would be erected a customs barrier to the interstate movement of oil.

CONCLUSION

The Colorado tax, at graduated rates, on the gross receipts from the sale or other disposition of Colorado oil and gas (a) is unjustifiably unequal, whimsical and arbitrary, and violates the due process and equal protection clauses of the Fourteenth Amendment, and (b) imposes a

direct and unreasonable burden on interstate commerce, and violates the commerce clause of the Constitution. The ruling of the Supreme Court of Colorado to the contrary is erroneous and presents substantial federal questions.

Respectfully submitted,

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